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(202) 224-1088

Contact: Kate Szostak

Opening Statement of Chairman Christopher Dodd "Madoff Investment Securities Fraud: Regulatory and Oversight Concerns and the Need for Reform"

Remarks as Prepared:

A year ago, the CEO of a trusted, respected securities firm and a former Chairman of Nasdaq said the following:

"In today's regulatory environment, it's virtually impossible to violate rules. This is something that the public really doesn't understand . . . it's impossible for a violation to go undetected, certainly not for a considerable period of time."

The speaker was none other than Bernard Madoff, and that cunning statement, he knew then and we know now, was breathtaking in its deception. In stark contrast to Mr. Madoff's statement, his fraud is noteworthy for its duration – it may well have lasted for decades – and the amount of money investors lost, which was nearly \$50 billion.

But for all his deception, Mr. Madoff was right about one thing: the public really didn't understand. Nor, it appears, did the regulators. Today we will discuss how the securities regulatory system failed to detect a fraud of this magnitude, the extent to which securities insurance will assist defrauded victims, and what can be done to prevent this sort of thing from happening again.

This much we know. Since Bernard L. Madoff Investment Securities LLC started in 1960, the firm has been subject to examination and oversight by the Securities and Exchange Commission and by the securities industry self-regulatory organization, the Financial Industry Regulatory Authority, or FINRA, and its predecessor, the NASD. The firm's clients have limited insurance through the Securities Investor Protection Corporation, SIPC.

Mr. Madoff pioneered electronic trading systems and was a Chairman of the Nasdaq Stock Market. Members of his family held leadership positions in the NASD.

At some point decades ago, Mr. Madoff began accepting money to invest from individuals, charities, pension funds, institutions and hedge funds. He sent these clients account statements on his firm's stationery. He charged only sales commissions. Reportedly, he told clients that the value of their accounts went up around 10% every year.

His reputation grew quickly. Some investors begged to be introduced to Mr. Madoff and for him to invest their funds.

Others weren't so sure. In 2001, *Barron's* reported some experts doubted his methodology and were troubled by his secrecy in an article entitled "Don't Ask, Don't Tell."

In 2005, derivatives expert Harry Markopolos gave the SEC staff a detailed 19-page paper entitled "The World's Largest Hedge Fund is a Fraud" in which he stated "Madoff Securities is the world's largest Ponzi Scheme. He identified numerous "red flags."

Returns that were too good to be true – consistent gains over 10% every year, in bull and bear markets alike. Investment strategies that could not produce stated returns. There was Madoff's practice of charging only commissions rather than the much larger percentage of assets and profits typically charged by advisers, curiously leaving hundreds of millions of dollars on the table.

It has been reported that the Madoff firm's auditor, Friehling and Horowitz, had only three employees, including a 78-year old Florida retiree and a secretary. The one actual accountant at the firm certified to the AICPA that he did not even perform audits.

All of these red flags were ignored.

In 2006, following an SEC examination, the Madoff brokerage firm also registered as an investment adviser. Yet somehow regulators missed a massive fraud.

Then on December 11, 2008, Mr. Madoff was arrested for securities fraud after he reportedly told his sons he had perpetrated "a giant Ponzi scheme" – that is, paying returns to certain investors out of the investments received from other investors. His assets and his firm's have been frozen.

As investigations are ongoing, let me say that we will respect these investigations and not ask you for facts which cannot be disclosed publicly at this time. However, I will ask that you be thorough and hold responsible the people who facilitated this securities fraud.

The media has reported breathlessly about certain celebrities who invested with Mr. Madoff. But most of those who lost their money because of this massive fraud were not celebrities or Hollywood stars.

They were municipalities, pension funds, charities, and individuals. Along with funds of funds, hedge funds, and foreign banks, these individuals have collectively lost billions of dollars. Some charities have shut down. The town of Fairfield, Connecticut alone has lost \$42 million.

Today we will hear from a Connecticut physician, Dr. Henry Backe, who will testify to the pension losses experienced by his colleagues and the nurses and other medical staff who support them.

How could regulators have missed so many warning signs? Did the examination staffs lack adequate expertise or numbers? Were they intimidated by Mr. Madoff's influence in the securities industry? Did they lack legal authority? Or, as I suspect, are there deeper problems?

Former Chairman Chris Cox has suggested as much. On December 16, he announced that credible and specific allegations going back to at least 1999 were "repeatedly brought to the attention of SEC staff, but were never recommended to the Commission for action." Indeed, in a decade's worth of inquiries into Mr. Madoff's firm, the SEC had not so much as issued a single subpoena.

For some investors, the breathtaking losses will be mitigated in part by the SIPC's insurance fund. Today, we want to hear what types of investors would be covered by SIPC and to encourage SIPC to gather Madoff's assets and provide payouts to eligible shareholders quickly.

The Madoff fraud was a regulatory failure of historic proportions. But what's most disturbing about it is that it went undetected until the perpetrator himself confessed. How many other "Madoff Schemes" are out there? Do we have any idea?

And so, today, we will also consider how we prevent crimes like these going forward – whether we require more resources or additional rulemaking or legislation. I will ask the SEC and FINRA to update this Committee every 3 months on the steps you are taking to prevent similar Madoff Schemes in the future.

Even if this is an extraordinary case, the Madoff fraud makes crystal clear how critical transparency and accountability are to our markets' continued success. It makes clear how inseparable proper oversight cops on the beat are to a dynamic, competitive financial system.

Our markets are only as strong as those who regulate them and the laws and values which market participants observe.

Going forward, the American people need to know that this Committee is committed to strengthening regulation, rebuilding confidence, and, above all, sending a clear message to investors across the world: The era of "Don't Ask, Don't Tell" on Wall St. is over.